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UNITED STATES PATENT AND TRADEMARK OFFICE

BEFORE THE BOARD OF PATENT APPEALS
AND INTERFERENCES

Ex parte ALEJANDRO M. PILATO

Appeal 2007-1553
Application 09/650,733
Technology Center 3600

Decided: January 10, 2008

Before LINDA E. HORNER, ANTON W. FETTING, and JOSEPH A. FISCHETTI , *Administrative Patent Judges.*

FETTING, *Administrative Patent Judge.*

DECISION ON APPEAL

STATEMENT OF CASE

Alejandro M. Pilato (Appellant) seeks review under 35 U.S.C. § 134 of a Final Rejection of claims 1-139, the only claims pending in this application.

We have jurisdiction over the appeal pursuant to 35 U.S.C. § 6.

We AFFIRM IN PART and ENTER NEW GROUNDS OF REJECTION UNDER 37 C.F.R. § 41.50(b).

The Appellant invented a way to outsource financial functions to an agent. An understanding of the invention can be derived from a reading of exemplary claims 1 and 114, which are reproduced below [bracketed matter and some paragraphing added].

> 1. A computer-assisted method
>
> for providing financial risk management functions by an agent for each of a plurality of institutional or corporate clients, comprising the activities of:
>
> [1] relating to a financial risk management function of each client:
>
> [a] demonstrating that more than one activity of the agent is transparent to the client;
>
> [b] receiving financial information at a computer of the agent;
>
> [c] creating risk management information relating to the financial information;
>
> [d] analyzing the risk management information in the context of the financial information;
>
> [e] determining an action based on the analysis;
>
> [f] facilitating implementation of the action on behalf of the client; and
>
> [g] communicating with the client through a network one or more activities of the agent.
>
> 114. A computer-assisted method for a client to outsource financial risk management functions to an agent representing a plurality of institutional or corporate clients, comprising the activities of:
>
> [1] providing financial information
>
> [a] on one or more financial risk management functions
>
> [b] of each client
>
> [c] to a computer of the agent;
>
> [2] enabling the agent

[a] to determine an action

[b] based on an analysis of risk management information

[c] created from the financial information; and

[3] allowing the agent

[a] to facilitate the implementation of the action.

This appeal arises from the Examiner's Final Rejection, mailed July 3, 2006. The Appellant filed an Appeal Brief in support of the appeal on October 13, 2006, and the Examiner mailed an Examiner's Answer to the Appeal Brief on November 16, 2006. A Reply Brief was filed on January 11, 2007.

PRIOR ART

The prior art references of record relied upon by the Examiner in rejecting the appealed claims are:

Stein	5,684,952	Nov. 4, 1997

McMenamin, *Financial Management: An Introduction*, New York, NY, 1999, pp. 15-17 and 20-21

Heath, *Strategic Issues Management: Organizations and Public Policy Challenges*, Sage Publications, Thousand Oaks, CA, 1997, pp. 86-87

Specification, pp. 1-2, as Admitted Prior Art (APA)

We also discuss the following art:

Levitt, *Speech by SEC Chairman: The Importance of Transparency in America's Debt Market*[1], U.S. Securities and Exchange Commission, Sep. 9, 1998

[1] http://ftp.sec.gov/news/speech/speecharchive/1998/spch218.htm

REJECTION

Claims 1-139 stand rejected under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Stein.

ISSUE

The issue pertinent to this appeal is whether the Appellant has sustained its burden of showing the Examiner erred in rejecting claims 1-139 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Stein.

FACTS PERTINENT TO THE ISSUE

The following enumerated Findings of Fact (FF) are believed to be supported by a preponderance of the evidence.

Claim Construction

01. The Specification contains no explicit lexicographic definition of the phrase "financial risk management function."

02. The usual and customary meaning of "risk" is (1) the possibility of suffering harm or loss; danger; (2) a factor, thing, element, or course involving uncertain danger; a hazard; (3) the danger or probability of loss to an insurer; (4) the amount that an insurance company stands to lose; (5) the variability of returns from an investment; (6) the chance of nonpayment of a debt; (7) one considered with respect to the possibility of loss.[2]

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[2] American Heritage Dictionary of the English Language (4th ed. 2000).

McMenamin

03. The financial management process is of a continuous, cyclical nature. It relies on information as inputs, and proceeds through the stages of (1) financial analysis, (2) financial decision-making, (3) financial planning, and (4) financial control, from which the cyclical process begins again (McMenamin 15:Fig. 1.8 and associated text).

04. Financial analysis includes identification of financial problems and risks (McMenamin 15:¶ Financial analysis).

05. Financial decision-making is made based on the findings of the review stage and includes strategic investment decision (McMenamin 15:¶ Financial decision-making).

06. The financial manager will be intimately involved in the financial evaluation and assessment of the options presented, in determining their respective costs, benefits and *risks* (McMenamin 16:Top ¶).

07. The decision-making phase will include the determination of the firm's financial objectives. In the context of the financial review, specific financial objectives will be set (McMenamin (16:¶ Financial objective-setting).

08. While it makes sense for a firm to use borrowed money, the firm will not wish to be overly dependent on borrowed money as this increases its financial *risk* (McMenamin 16:Second full ¶ from the bottom).

Heath

09. In managing strategic issues, situation analysis of issues can be segmented into (1) scanning for emerging issues; (2) researching,

analyzing, and forecasting the issues; (3) prioritizing the many issues identified by the scanning and research stages; and (4) developing strategic and issue operations or action plans (Heath 86:Top ¶).

10. Implementation is a component of strategic issues management (Heath 86:Second ¶).

Stein

11. Stein is directed towards enabling an administrator to monitor and control individual workstations within a network (Stein, col. 1, ll. 10-15).

Admitted Prior Art

12. Outsourcing can be an option for managing non-core, but vital, functions. Outsourcing has grown into an important service industry, particularly for support functions. Typical functions being outsourced are IT maintenance and support, facilities, security, etc. In the financial sector, typical functions being outsourced tend to be restricted to back-office functions such as settlements, clearing, safe custody, etc. More recently, however, all firms have begun to outsource functions that were previously considered too close to either the strategic management of the core business or to the identity of the firm for outsourcing. JP Morgan outsourced both the ownership and management of the buildings from which it operates in the major financial centers (Specification 2:1-11).

PRINCIPLES OF LAW

Claim Construction

During examination of a patent application, pending claims are given their broadest reasonable construction consistent with the specification. *In re Prater*, 415 F.2d 1393, 1404-05 (CCPA 1969); *In re Am. Acad. of Sci. Tech Ctr.*, 367 F.3d 1359, 1364 (Fed. Cir. 2004).

Limitations appearing in the specification but not recited in the claim are not read into the claim. *E-Pass Techs., Inc. v. 3Com Corp.*, 343 F.3d 1364, 1369 (Fed. Cir. 2003) (claims must be interpreted "in view of the specification" without importing limitations from the specification into the claims unnecessarily)

Although a patent applicant is entitled to be his or her own lexicographer of patent claim terms, in *ex parte* prosecution it must be within limits. *In re Corr*, 347 F.2d 578, 580 (CCPA 1965). The applicant must do so by placing such definitions in the Specification with sufficient clarity to provide a person of ordinary skill in the art with clear and precise notice of the meaning that is to be construed. *See also In re Paulsen*, 30 F.3d 1475, 1480 (Fed. Cir. 1994) (although an inventor is free to define the specific terms used to describe the invention, this must be done with reasonable clarity, deliberateness, and precision; where an inventor chooses to give terms uncommon meanings, the inventor must set out any uncommon definition in some manner within the patent disclosure so as to give one of ordinary skill in the art notice of the change).

Obviousness

A claimed invention is unpatentable if the differences between it and the prior art are "such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art." 35

U.S.C. § 103(a) (2000); *KSR Int'l v. Teleflex Inc.*, 127 S.Ct. 1727 (2007); *Graham v. John Deere Co.*, 383 U.S. 1, 13-14 (1966).

In *Graham*, the Court held that that the obviousness analysis is bottomed on several basic factual inquiries: "[(1)] the scope and content of the prior art are to be determined; [(2)] differences between the prior art and the claims at issue are to be ascertained; and [(3)] the level of ordinary skill in the pertinent art resolved." 383 U.S. at 17. *See also KSR Int'l v. Teleflex Inc.*, 127 S.Ct. at 1734. "The combination of familiar elements according to known methods is likely to be obvious when it does no more than yield predictable results." *KSR*, at 1739.

"When a work is available in one field of endeavor, design incentives and other market forces can prompt variations of it, either in the same field or in a different one. If a person of ordinary skill in the art can implement a predictable variation, § 103 likely bars its patentability." *Id.* at 1740.

"For the same reason, if a technique has been used to improve one device, and a person of ordinary skill in the art would recognize that it would improve similar devices in the same way, using the technique is obvious unless its actual application is beyond his or her skill." *Id.*

"Under the correct analysis, any need or problem known in the field of endeavor at the time of invention and addressed by the patent can provide a reason for combining the elements in the manner claimed." *Id.* at 1742.

Automation of a Known Process

It is generally obvious to automate a known manual procedure or mechanical device. Our reviewing court stated in *Leapfrog Enterprises Inc. v. Fisher-Price Inc.*, 485 F.3d 1157 (Fed. Cir. 2007) that one of ordinary skill in the art would have found it obvious to combine an old electromechanical device with electronic

circuitry "to update it using modern electronic components in order to gain the commonly understood benefits of such adaptation, such as decreased size, increased reliability, simplified operation, and reduced cost. . . . The combination is thus the adaptation of an old idea or invention . . . using newer technology that is commonly available and understood in the art." *Id.* at 1163.

Obviousness and Nonfunctional Descriptive Material

Nonfunctional descriptive material cannot render non-obvious an invention that would have otherwise been obvious. *In re Ngai*, 367 F.3d 1336, 1339 (Fed. Cir. 2004). Cf. *In re Gulack*, 703 F.2d 1381, 1385 (Fed. Cir. 1983) (when descriptive material is not functionally related to the substrate, the descriptive material will not distinguish the invention from the prior art in terms of patentability).

ANALYSIS

Claims 1-139 rejected under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Stein.

Claims 1, 112-114, and 136-139 are independent. Of these, claims 1, 112, 113, and 138 require demonstrating that more than one activity is transparent to a client. The limitations in the bodies of each independent claim are summarized as follows.

Independent Claim								Contains Limitation
1	112	113	114	136	137	138	139	
X	X	X						1) relating to a financial function of each client
						X	X	2) regarding a financial risk management function of a client from a plurality of clients
X	X	X				X		3) demonstrating that more than one activity of the agent is transparent to the client

X	X	X				X	X	4) receiving financial information at a computer of the agent
X	X	X						5) creating risk management information relating to the financial information
X	X	X				X	X	6) analyzing the risk management information in the context of the financial information
X	X	X						7) determining an action based on the analysis
X	X	X	X	X	X	X	X	8) facilitating implementation of the action on behalf of the client
X	X	X					X	9) communicating with the client through a network one or more activities of the agent
			X	X	X			10) providing financial information on one or more financial risk management functions of each client to a computer of the agent
			X	X	X			11) enabling the agent to determine an action based on an analysis of risk management information created from the financial information

The Examiner found that McMenamin describes activities relating to financial risk management, which is a financial function; receiving financial information; creating and analyzing risk management information in the context of the financial information; and determining an action based on the analysis (Limitations 1, 2, 4-7, and 10-11 in the above table) (Answer 4:Regarding Claim 1 …). The Examiner found that McMenamin failed to describe the remaining limitations of claim 1, but found that one of ordinary skill would have known to automate the steps of McMenamin (claim preambles) (Answer 5:First full ¶); that one of ordinary skill would have known to implement the decisions (Limitation 8 in the above table) described by McMenamin because of the notoriety of implementing decisions as

evidenced by Heath (Answer 5:Last ¶ - continuing to Answer 6); that performing a method by an agent (claim preambles) and communicating such activities (Limitation 9 in the above table) is described by the Appellant's admitted prior art (Answer 6:First full ¶); and that transparency in use of a computer (Limitation 3 in the above table) is described by Stein (Answer 6:Last ¶ - continuing on to Answer 7).

The Appellant presents a 295 page brief to argue against the Examiner's rejections. It is highly repetitious and therefore we will respond to it in a summarized fashion. Regarding the independent claims, the Appellant contends that (1) the rejections are premised upon an improper construction of the phrase "financial risk management" (see e.g., Appeal Br. 35-37); (2) the rejections improperly characterize portions of the Appellant's Specification on pp. 1 and 2 as admitted prior art (see e.g., Appeal Br. 39-40); (3) none of the applied art recites a "financial risk management function" (see e.g., Appeal Br. 40-41); (4) there is no motivation to combine the references (see e.g., Appeal Br. 41-44); (5) there is no reasonable expectation of success from combining the applied art (see e.g., Br. 44-45); (6) the Examiner improperly relied upon *In re Venner*, 262 F.2d 91 (CCPA 1958) to support an argument of obviousness to automate (se e.g., Appeal Br. 46); and (7) Stein is an improper reference to show the claim limitation of demonstrating transparency (see e.g., Appeal Br. 46-47).

Regarding those independent claims 1, 112, 113, and 138 which require demonstrating that more than one activity is transparent to a client, the Appellant contends that one of ordinary skill would not have selecting anything from Stein, and that the Examiner failed to show otherwise (Appeal Br. 46:Last full ¶). The

Examiner responds that one of ordinary skill would have allowed the client to supervise the agent and allow communication (Answer 42:First full ¶).

We find that Stein is directed towards enabling an administrator to monitor and control individual workstations within a network (FF 11). Claim element 1.a and the analogous element in claims 112, 113, and 138 require no transparency of supervision and communication as argued by the Examiner, but a demonstration that an activity is transparent within a financial information context. Stein makes no reference to financial transparency. Thus, we find that the Examiner has not shown that it would have been obvious to one of ordinary skill to demonstrate financial transparency as required by independent claim 1, 112, 113, 138, and the claims 2-111 that depend therefrom and the Appellant has met its burden of showing the Examiner erred in rejecting these claims as obvious.

As to claims 114, 136, 137, and 139, we find that McMenamin and Heath describe the limitations of these claims as found by the Examiner. We now consider the contentions raised by the Appellant.

Contention - The rejections are premised upon an improper construction of the phrase "financial risk management."

The Appellant contends that the phrase "financial risk management function" is implicitly defined in the Specification (Appeal Br. 35:First through fifth ¶'s). The Appellant points to references to financial functions (Specification 1:5-7); examples of financial functions, including treasury, credit management, risk management, and trading (Specification 2:16-17); and front, middle, and back office financial functions (Specification 3:1-3) to support the contended implicit

definition. The Appellant points to no explicit definition in the Specification and we have not found one.[3]

Although an inventor is free to define the specific terms used to describe the invention, this must be done with reasonable clarity, deliberateness, and precision. *In re Paulsen*, 30 F.3d at 1480. The Specification contains no lexicographic definition of "financial risk management" or even "risk." The usual and customary meaning of risk is the possibility of suffering harm or loss. In financial contexts, this may mean insurance losses, variability of investment returns, chance of nonpayment of debt or one considered with respect to the possibility of loss (FF 01-02). Thus, financial risk management is the management of the possibility of financial loss through insurance management, investment management, or debt management.

This construction is well within the scope of those portions of the Specification pointed to the Appellant. Management of financial risk is a financial function and would be within the realm of including treasury, credit management, and risk management. Certainly back office operations involved in financial analysis and control would include risk management within their scope.

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[3] The Appellant also attaches an affidavit as an appendix to the Appeal Brief that refers to the construction of this phrase (Affidavit 2-3:¶ 12). The Appellant does not refer to this affidavit in the Appeal Brief, and the affidavit appears to be directed towards art that is not applied in any of the rejections at issue. Therefore, the construction proffered by the affiant appears to be moot. In any event, the construction suggested by the affiant is one that would limit its scope to a reader of certain books, and such a limited construction is not supported by the Specification.

With this construction of financial risk management, McMenamin's description of the financial management process which determines costs, benefits and risks in the evaluations and assessments of financial planning options is one of managing financial risks. Thus, we cannot say that the rejections are premised upon an improper construction of the limitation of financial risk management.

Contention - the rejections improperly characterize portions of the Appellant's Specification on pp. 1 and 2 as admitted prior art.

The Specification states that outsourcing can be an option for managing non-core, but vital, functions. Outsourcing has grown into an important service industry, particularly for support functions. Typical functions being outsourced are IT maintenance and support, facilities, and security. In the financial sector, typical functions being outsourced tend to be restricted to back-office functions such as settlements, clearing, and safe custody. The Specification states that more recently, all firms have begun to outsource functions that were previously considered too close to either the strategic management of the core business or to the identity of the firm for outsourcing. JP Morgan outsourced both the ownership and management of the buildings from which it operates in the major financial centers (FF 12).

This is a characterization of the state of the art by the Appellant, and as such is an admission of the state of the art. The Appellant contends that one's own work may not be used as prior art absent some statutory basis (Appeal Br. 40:Second from bottom ¶). A statement by an applicant during prosecution identifying the work of another as "prior art" is an admission that that work is available as prior art against the claims, regardless of whether the admitted prior art would otherwise qualify as prior art under the statutory categories of 35 U.S.C. § 102. *Riverwood*

Int'l Corp. v. R.A. Jones & Co., 324 F.3d 1346, 1354 (Fed Cir. 2003). Thus, the Appellant has not shown that those statements characterized in the Specification as the state of the art by others is not admitted prior art.

Contention – none of the art recites a financial risk management function.

McMenamin describes the financial management process as one that determines costs, benefits and risks in the evaluations and assessments of financial planning options. This description of financial management includes managing financial risks. Thus, we find that McMenamin does recite a function of financial risk management.

Contention – there is no motivation to combine the references.

McMenamin describes a financial planning and management process, one that inherently scans for emerging financial issues for evaluation and assessment. Heath describes the process of managing strategic issues such as the financial issues surfaced by the process of McMenamin. Thus, at least McMenamin and Heath are complementary and would therefore have been combined to effectively implement plans addressing strategic financial issues by one of ordinary skill. Although for the reasons we found *supra*, we agree that there would have been no motivation to combine Stein with McMenamin and Heath, the rejection of claims 114, 136, 137, and 139 do not require Stein, although the Examiner nominally applied it, apparently as an expedient.

The Appellant also introduces several additional arguments under the rubric of lack of motivation. In particular, the Appellant contends that computer assisted methods or agent functions are not taught by McMenamin (Appeal Br. 41:Last full ¶). The Appellant also contends that Heath is not in the same field of endeavor as the claimed invention (Appeal Br. 42-43).

It is generally obvious to automate a known manual procedure or mechanical device. *See Leapfrog Enterprises Inc. v. Fisher-Price Inc.* 485 F.3d 1157 (Fed. Cir. 2007). The admitted prior art demonstrates that outsourcing services to agents was known at the time of the invention (FF 12). Although the admitted prior art does not state that outsourcing was used for financial risk management, "[w]hen a work is available in one field of endeavor, design incentives and other market forces can prompt variations of it, either in the same field or a different one. If a person of ordinary skill can implement a predictable variation, § 103 likely bars its patentability. For the same reason, if a technique has been used to improve one device, and a person of ordinary skill in the art would recognize that it would improve similar devices in the same way, using the technique is obvious unless its actual application is beyond his or her skill." *KSR,* 127 S. Ct. at 1740. The techniques of hiring an agent are sufficiently similar among various markets, that one of ordinary skill would have known how to hire an agent for financial risk management at the time of the invention. Also, as noted in *KSR*, when a work is available in one field of endeavor, design incentives and other market forces can prompt variations of it, either in the same field or a different one. Clearly strategic issues management described by Heath is a critical aspect of financial risk assessment described by McMenamin. Further, Heath is applied only as evidence of the common sense proposition that having made a plan as in McMenamin, it ought to be implemented. This is hardly a novel idea. "The obviousness analysis cannot be confined by a formalistic conception of the words teaching, suggestion, and motivation, or by overemphasis on the importance of published articles and the explicit content of issued patents. The diversity of inventive pursuits and of modern technology counsels against limiting the analysis in this way. In many fields it may be that there is little discussion of obvious techniques or

combinations, and it often may be the case that market demand, rather than scientific literature, will drive design trends." *Id.* at 1741.

Contention – there is no reasonable expectation of success.

It is difficult to fathom how there can be no reasonable expectation of success in outsourcing a service. One calls the agent, tells them what one wants and gets out of the way. The claims do not predict the actual outcomes of the outsourcing, but only the act of having a service outsourced, so the success of the agent is irrelevant.

The Appellant contends that the art provides only general guidelines (Appeal Br. 45:Second to bottom ¶). To which we respond that in outsourcing, not much more is needed. One calls the agent, tells them what one wants and gets out of the way. The Appellant provides no contention that the process of commissioning an agent is unduly difficult or unpredictable. Thus we cannot say that there is no reasonable expectation of success.

Contention –the Examiner improperly relied upon In re Venner.

The Examiner cited *Venner* for the proposition that it is obvious to automate a process (Answer 5). The Appellant spends considerable ink arguing that *Venner* was overruled and is not applicable (Appeal Br. 41-42 and 46). We need not consider the pertinence of *Venner* because our reviewing court has recently spoken again on the obviousness to automate. A combination that is the adaptation of an old idea or invention using newer technology that is commonly available and understood in the art would have been obvious to one of ordinary skill in the. *Leapfrog, id* at 1163. Thus, irrespective of the status of *Venner*, our reviewing court has held that automation of what is known is obvious, which supports the Examiner's findings in which the Examiner cited *Venner*.

Thus, as to independent claims 114, 136, 137 and 139, the Appellant has not met its burden of showing the Examiner erred in rejecting these claims.

Dependent claims 115-135

Dependent claims 115-135 recite the added limitations as follows (most of the added limitations recited the acquisition of information):

> receiving risk management information generated by the agent at the client (claim 115).
>
> receiving the agent's analysis at the client (claim 116).
>
> receiving an action instruction at the client (claim 117).
>
> receiving an action recommendation at the client (claim 118).
>
> receiving a notification at the client of an action that will be implemented by the agent (claim 119).
>
> receiving a notification at the client of an implemented action (claim 120).
>
> requesting notification of an effect of one or more actions of the agent on the risk management analysis (claim 124).
>
> requesting notification of the effect of one or more alternative actions of the agent on the risk management information (claim 125).
>
> requesting information on one or more reasons behind an action determined by the agent (claim 126).
>
> requesting an audit log of one or more of historical activities of the agent on behalf of the client (claim 127).
>
> requesting a review of one or more of historical activities of the agent (claim 128).
>
> providing financial information to the agent (claim 129).
>
> new financial information to the agent based on a review of one or more of historical activities of the agent (claim 130).

Having a client receive information from an outsourced service is simply feedback that is inherent in any rational employment of outsourced services.

Requesting notification is the act by which such reception occurs. While an infinite number of information requests might be envisaged, any that reasonably would provide insight as to the efficacy of the outsourced services would be common sense and therefore obvious. *See KSR,* 127 S. Ct. at 1742. All of the requests recited in these claim limitation are for financial, historical, or implementation information that shed light on the efficacy of that which is outsourced, all of which would have been within the knowledge of one of ordinary skill to ask an outsourcing agent.

Several claims deal with using a network for communication:

> accessing information across a network on one or more of the agent's activities (claim 121).
>
> monitoring across a network one or more of the agent's activities (claim 122).
>
> silently monitoring across a network one or more of the agent's activities (claim 123).
>
> the financial information is provided through a network (claim 135).

Certainly the notoriety of financial communication networks in an era of ATMs and online day trading (Schwab[4] began in 1995) is far too extensive to seriously question. Further, under *Leapfrog,* it would have been obvious to use electronic technology for communication.

Finally, several claims deal with the power granted to the agent to whom services are outsourced:

> removing the agent's authority to undertake any action on behalf of the client (claim 131).

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[4] See http://www.aboutschwab.com/about/overview/history.html

> removing the authority of the agent in connection with one or more actions (claim 132).
>
> requesting the agent to halt one or more actions (claim 133).
>
> requesting, through a network, the agent to halt one or more actions (claim 134).

These represent elementary examples of the powers one exercises over an agent and therefore would have been known to one of ordinary skill. Certainly no one with a modicum of skill would allow an agent to run rampant without exercising at least the level of discretionary control such as these.

The Appellant contended the rejections of these claims in Appeal Br. 230-245. The contentions generally argued improper motivation to combine, which we responded to *supra*, and improper grouping of claims. We have grouped the claims above to more readily show the common features among these claims and how we found them to be obvious.

NEW GROUND OF REJECTION

We enter a new ground of rejection of claims 1-112, 114-136, 138, and 139 under 35 U.S.C. § 101 as directed to nonstatutory subject matter.

ADDITIONAL PRINCIPLES OF LAW

35 U.S.C. §101 provides:

> Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.

This has been interpreted as follows:

> In choosing such expansive terms as 'manufacture' and 'composition of matter,' modified by the comprehensive 'any,' Congress plainly contemplated that the patent laws would be given wide scope.

Diamond v. Chakrabarty, 447 U.S. 303, 308 (1980).

That wide scope nevertheless excludes laws of nature, natural phenomena, and abstract ideas. "Such discoveries are 'manifestations of . . . nature, free to all men and reserved exclusively to none.'" *Id.* at 309, (quoting *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127, 130 (1948)). "Phenomena of nature, though just discovered, mental processes, and abstract intellectual concepts are not patentable, as they are the basic tools of scientific and technological work." *Gottschalk v. Benson*, 409 U.S. 63, 67 (1972).

Thus, the claimed invention as a whole must accomplish a practical application. That is, it must produce a "useful, concrete and tangible result." *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368, 1373 (Fed. Cir. 1998). The purpose of this requirement is to limit patent protection to inventions that possess a certain level of "real world" value, as opposed to subject matter that represents nothing more than an idea or concept, or is simply a starting point for future investigation or research. *See e.g., Brenner v. Manson*, 383 U.S. 519, 528-36 (1966); *In re Ziegler* 992, F.2d 1197, 1200-03 (Fed. Cir. 1993)). A process that consists solely of the manipulation of an abstract idea is not concrete or tangible. *See In re Warmerdam*, 33 F.3d 1354, 1360 (Fed. Cir. 1994). *See also In re Schrader*, 22 F.3d 290, 295 (Fed. Cir. 1994).

ANALYSIS

Claims 1-111, 114-135, 138 and 139 are directed toward methods of creating, analyzing and receiving risk information and communicating activities. Claims 112 and 136 are directed towards software instructions to perform these methods. The claims are not directed towards improving the mechanisms of creation, analysis, reception, and communication of information, but just towards the

application of these generic activities to financial risk management. Financial information is the epitome of abstract information in itself. Communicating activities is not performance of the activities themselves, but merely information about the activities that is transmitted. Creating, analyzing, receiving and communicating abstract information does not make the abstract information concrete and tangible, nor does it produce a concrete and tangible result. Automating the process does not make the results any more concrete or tangible either.

At the end of the day, these claims do no more than indicate information that an agent communicates to a client, and the instructions that the client may give to the agent. Hence the methods produce no useful, concrete and tangible result, but only provide a communication of such intellectual pursuits between two parties.

ADDITIONAL NEW GROUND OF REJECTION

We enter a new ground of rejection of claims 1-139 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Levitt.

ADDITIONAL FINDINGS OF FACT (FF)

We make the following additional enumerated findings of fact, which are supported by at least a preponderance of the evidence.

13. Levitt describes the necessity for transparency in financial transactions. He states that "[t]ransparency, disclosure and accountability aren't just catchwords. They are the essential ingredients to confidence. And without it, markets can neither sustain long-term growth nor adapt to a rapidly changing environment (Levitt 2:Third ¶).

ANALYSIS

As we found above, the art applied by the Examiner described all of the limitations of the independent claims, except for those independent claims 1, 112, 113, and 138 where the art did not describe demonstrating that more than one activity is transparent to a client. Levitt describes the paramount necessity for transparency, disclosure and accountability in financial transactions (FF 13). Thus one of ordinary skill would have known to meet this professed necessity by demonstrating the transparency of the financial transaction activities that would be performed for financial risk management. Therefore, as to the independent claims 1, 112-114, and 136-139, the claimed subject matter would have been obvious to one of ordinary skill over McMenamin, Heath, Levitt and the admitted prior art.

As to dependent claims 2-111, they are more readily treated according to their limitations in common.

Claims specifying the information

Several claims added the limitation that specific information was provided:

> includes providing a notification. (claim 9)
>
> includes providing a report. (claim 10)
>
> includes providing an analysis. (claim 11)
>
> includes providing information. (claim 12)
>
> comprising reporting one or more effects of the agent's action on the risk management information. (claim 21)
>
> comprising reporting one or more effects of an alternative action to the agent's action on the risk management information. (claim 22)
>
> comprising reporting one or more reasons behind an action determined by the agent. (claim 23)
>
> includes providing an audit log of one or more historical activities of the agent on behalf of the client. (claim 24)

includes informing the client of results of reviews of one or more of historical activities of the agent. (claim 25)

includes financial guidelines. (claim 39)

includes one or more benchmarks. (claim 40)

includes action guidelines. (claim 41)

includes market risk limits. (claim 42)

includes credit risk limits. (claim 43)

includes liquidity guidelines. (claim 44)

includes maturity guidelines. (claim 45)

includes credit guidelines. (claim 46)

includes detailed information on financial instruments relevant to a financial risk management function. (claim 96)

includes historical market data relevant to the financial risk management function. (claim 97)

includes current market data relevant to the financial risk management function. (claim 98)

includes economic information relevant to the financial risk management function. (claim 99)

includes information relevant to the financial risk management function. (claim 100)

includes strategic financial objectives. (claim 101)

The nature of information that is provided does not alter the function of the claimed methods. It is nonfunctional descriptive material.

Nonfunctional Descriptive Material

Descriptive material can be characterized as either "functional descriptive material" or "nonfunctional descriptive material." Exemplary "functional

descriptive material" consists of data structures[5] and computer programs, which impart functionality when employed as a computer component. "Nonfunctional descriptive material" includes but is not limited to music, literary works and a compilation or mere arrangement of data.

When presented with a claim comprising descriptive material, an Examiner must determine whether the claimed nonfunctional descriptive material should be given patentable weight. The Patent and Trademark Office (PTO) must consider all claim limitations when determining patentability of an invention over the prior art. *In re Gulack*, 703 F.2d 1381, 1385 (Fed. Cir. 1983). The PTO may not disregard claim limitations comprised of printed matter. *See Gulack*, 703 F.2d at 1384; *see also Diamond v. Diehr*, 450 U.S. 175, 191 (1981). However, the examiner need not give patentable weight to descriptive material absent a new and unobvious functional relationship between the descriptive material and the substrate. *See In re Lowry*, 32 F.3d 1579, 1583-84 (Fed. Cir. 1994); *In re Ngai*, 367 F.3d 1336, 1338 (Fed. Cir. 2004).

Thus, when the prior art describes all the claimed structural and functional relationships between the descriptive material and the substrate, but the prior art describes a different descriptive material than the claim, then the descriptive material is nonfunctional and will not be given any patentable weight. That is, we conclude that such a scenario presents no new and unobvious functional relationship between the descriptive material and the substrate.

Thus, in the context of the above claims which describe the nature of the information conveyed, which is nonfunctional descriptive material, this presents no

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[5] The definition of "data structure" is "a physical or logical relationship among data elements, designed to support specific data manipulation functions." *The New*

new and nonobviousness relationship. We further find that all of the information so described, e.g. reports, analyses, guidelines, benchmarks, relevant data and audit logs, are well within the scope of what financial managers would typically expect to communicate.

Claims specifying the financial risk management function

Many claims simply further specify the nature of the financial risk management function:

> includes short-term funding and cash management. (claim 47)
> includes cash flow management. (claim 48)
> includes liquidity management. (claim 49)
> includes cash management. (claim 50)
> includes investment management. (claim 51)
> includes repo (repurchase agreement) funding. (claim 52)
> includes debt management. (claim 53)
> includes debt issuance. (claim 54)
> includes asset and liability management. (claim 55)
> includes asset and liability management and wherein the assets include insurance premia. (claim 56)
> includes asset and liability management and wherein the liabilities include insurance claims. (claim 57)
> includes asset and liability management and wherein the assets include life insurance premia. (claim 58)
> includes asset and liability management and wherein the liabilities include life insurance claims. (claim 59)
> includes asset and liability management and wherein the liabilities include pension claims. (claim 60)

IEEE Standard Dictionary of Electrical and Electronics Terms 308 (5th ed. 1993).

includes asset and liability management and wherein the liabilities include legal claims. (claim 61)

includes asset and liability management wherein the assets include leases. (claim 62)

includes asset and liability management wherein the liabilities include leases. (claim 63)

includes asset and liability management wherein the assets include operational cashflows. (claim 64)

includes asset and liability management wherein the liabilities include operational cashflows. (claim 65)

includes treasury management. (claim 66)

includes credit management. (claim 67)

includes credit spread trading. (claim 68)

includes loan portfolio management. (claim 69)

includes equity portfolio management. (claim 70)

includes fixed income portfolio management. (claim 71)

includes funding. (claim 72)

includes collateral management. (claim 73)

includes the lending of securities. (claim 74)

includes the borrowing of securities. (claim 75)

includes counterparty credit exposure management. (claim 76)

includes financial risk management. (claim 77)

includes market risk management. (claim 78)

includes credit risk management. (claim 79)

includes commodity price risk management. (claim 80)

includes liquidity risk management. (claim 81)

includes operational risk management. (claim 82)

includes management of insurable risks. (claim 83)

includes electricity price risk management. (claim 84)

includes pension fund management. (claim 85)
includes real estate management. (claim 86)
includes hedging. (claim 87)
includes dynamic hedging. (claim 88)
includes mortgage pre-payment risk management. (claim 89)
includes front-office activities. (claim 90)
includes middle-office activities. (claim 91)
includes back-office activities. (claim 92)
includes front-office and middle-office activities. (claim 93)
includes middle-office and back-office activities. (claim 94)
includes front-office, middle-office and back-office activities. (claim 95)

As such, these claims simply present different market contexts within which the steps of claim 1 are performed. "When a work is available in one field of endeavor, design incentives and other market forces can prompt variations of it, either in the same field or a different one. If a person of ordinary skill can implement a predictable variation, § 103 likely bars its patentability." *KSR, id.* at 1740. One of ordinary skill in financial risk management would have considered all of these financial risk niches to be within the scope of what might be managed under financial risk management, since they are all known aspects of financial risk management. Certainly one of ordinary skill within any one of these niches would have both known of that niche and considered that niche to be within the scope of financial risk management. Further, none of these niches have any functional bearing on the steps performed in claim 1, but act only to limit the field of use in which the steps of claim 1 are performed.

Claims specifying the clients

Several of the claims limit the nature of the clients:

includes departments of the client. (claim 102)

includes subsidiaries of the client. (claim 103)

includes affiliates of the client. (claim 104)

includes clients of the client. (claim 105)

includes regulators of the client. (claim 106)

includes auditors of the client. (claim 107)

includes agents of the client. (claim 108)

includes advisors of the client. (claim 109)

includes counterparties of the client. (claim 110)

includes shareholders of the client. (claim 111)

As with the prior group of claims that limited the nature of the risk, these limitations do no more than limit the market of clients for which the steps are performed and thus the field of use. One of ordinary skill in any field of financial services outsourcing, including financial risk management, would have considered all of these clients to be within the scope of those who might be served, since they are all parties with obvious interests in the financial status of an enterprise.

Claims enabling the information

Several of the claims require enabling or allowing the client to get information:

includes enabling the client to access information regarding one or more activities of the agent. (claim 13)

includes enabling the client to access information across a network regarding one or more activities of the agent. (claim 14)

includes allowing the client to monitor across a network one or more activities of the agent. (claim 15)

includes allowing the client to monitor in real-time across a network one or more activities of the agent. (claim 16)

includes allowing the client to monitor in near-real-time across a network one or more activities of the agent. (claim 17)

Enabling such monitoring is at least suggested by Levitt's description of the necessity for transparency. Thus, this claimed subject matter would have been obvious to provide such transparency.

Claim specifying feedback

One claim requires feedback:

> includes seeking feedback from the client on reviews of one or more of historical activities of the agent. (claim 26)

McMenamin describes the cyclical nature of the financial management process which includes feedback from information fed into the analysis. Since the activities performed in financial operations would produce such information, feedback from those activities would be produced in the normal course of financial management. Thus such feedback would have been an inherent and, therefore, obvious step in financial management of McMenamin.

Claims specifying agent attributes

Two claims limit the freedom of the agent:

> wherein the agent is conflict-free. (claim 27)
>
> comprising the agent receiving authority to implement the action on behalf of the client. (claim 28)

Since conflicts of interest are generally discouraged if not prohibited in any field of agency, and agents necessarily must have the authority to implement whatever they are to implement, these limitations are obvious in view of the law and practice of agency in general.

Claims specifying implementation attributes

Several claims limit the nature of implementing actions:

> includes implementing the action on behalf of the client. (claim 3)

includes instructing the client to implement the action. (claim 4)

includes recommending that the client implement the action. (claim 5)

comprising notifying the client that an action will be implemented by the agent. (claim 6)

comprising notifying the client of the action implemented by the agent. (claim 7)

comprising receiving notification from the client of an action implemented by the client. (claim 8)

comprising the client agreeing to implement actions recommended by the agent. (claim 29)

comprising the client agreeing to implement actions instructed by the agent. (claim 30)

The whole point of planning is for implementation. Heath explicitly recites the need for implementation (FF 10). Thus, implementation by any party involved in a plan, including the client or the agent, and instructing, notifying or otherwise communicating the actions for implementation, would have been obvious parts of the step of implementation of plans such as those in McMenamin to one of ordinary skill. As to which party will perform the implementation and how that is communicated, the planning process, generally described by McMenamin, hashes out such details as a matter of course.

Claims specifying a result

Six claims specify the nature of a result of the steps in claim 1:

results in the negotiation of the terms of a trade. (claim 31)

includes an identification of a best rate or price at which the trade can be executed. (claim 32)

results in execution of a trade. (claim 34)

results in execution of a trade with a third party. (claim 35)

results in execution of a trade by the agent. (claim 36)

results in execution of a trade by the client. (claim 37)

Since terms of a trade or a best price are typical goals of financial planning such as that described by McMenamin, one of ordinary skill would expect the first two results from the planning process of McMenamin. "A person of ordinary skill is also a person of ordinary creativity, not an automaton." *KSR, id.* at 1742. It would take a minimum of creativity to see that terms of trade and optimal pricing are goals of financial planning. Thus these would have been obvious for being typical goals of financial planning. As to the results of executions of trades, any financial risk management surrounding the use of financial securities or derivatives would inherently incorporate these results as these are the mechanisms by which financial securities are transacted. The parties executing the trades recited in the claims are those one of ordinary skill would have known to be candidates. "Common sense teaches … that familiar items may have obvious uses" *KSR, id* at 1742. Similarly, common parties to transactions can be expected to be parties to those transactions.

More to the point, there is no functional connection between the steps of claim 1 and these results. Thus these results are not functionally provided by the steps of claim 1 and are therefore aspirational rather than functional limitations. The limitations are achieved by happenstance of what an agent does outside of the scope of claim 1, not by operation of claim 1's steps. Thus, these limitations are functionally no different from those in which an agent is instructed by nonfunctional descriptive material to achieve such results. As such, these limitations deserve minimal patentable weight.

Claims specifying automation

Several claims require the use of a communication network or of automation of the determining and implementing steps:

> financial information is received through a network. (claim 2)
>
> includes reporting to the client across a network one or more activities of the agent. (claim 18)
>
> includes reporting to the client in real-time across a network one or more activities of the agent. (claim 19)
>
> includes reporting to the client in near-real-time across a network one or more activities of the agent. (claim 20)
>
> said activity of determining the action is performed automatically. (claim 33)
>
> implemented automatically. (claim 38)

A combination that is the adaptation of an old idea or invention using newer technology that is commonly available and understood in the art is obvious to one of ordinary skill. *See Leapfrog, id.* at 1163. As we found with respect to claims 115-135, *supra*, the notoriety of financial communication networks in an era of ATMs and online day trading is far too extensive to seriously question. Electronic communication was far too extensive at the time of the invention to seriously question its obviousness to one of ordinary skill. The aspect of real-time reporting is in the eye of the beholder. E-mail and instant messaging have made real-time communication a habit for most of the electronically served population, and the speed with which financial information is known to grow stale makes near-real time communication obligatory and therefore obvious to one of ordinary skill. As to automation of implementation and determination, the claims do not specify the nature of the automation, and in an era of graphical user interfaces with radio buttons and control boxes, entering data related to the information in claim 1 can be construed as parts of the determining and implementing steps.

Thus, all of the dependent claims 2-111 would have been obvious to one of ordinary skill over McMenamin, Heath, Levitt, and the admitted prior art, in view of the knowledge of one of ordinary skill in financial risk management. Claims 115-135 were found to be obvious over McMenamin, Heath, and the admitted prior art, in view of the knowledge of one of ordinary skill in financial risk management in the analysis of the Examiner's rejections, *supra*, and those findings are applicable here as well.

CONCLUSIONS OF LAW

The Appellants have sustained their burden of showing that the Examiner erred in rejecting claims 1-113 and 138, but have not sustained their burden of showing that the Examiner erred in rejecting claims 114-137 and 139 under 35 U.S.C. § 103(a) as unpatentable over the prior art.

We enter a new ground of rejection of claims 1-112, 114-136, 138 and 139 under 35 U.S.C. § 101 as directed to nonstatutory subject matter.

We enter a new ground of rejection of claims 1-139 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Levitt.

DECISION

To summarize, our decision is as follows:

- The rejection of claims 1-113 and 138 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Stein is not sustained.
- The rejection of claims 114-137 and 139 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Stein is sustained.
- A new ground of rejection of claims 1-112, 114-136, 138 and 139 under 35 U.S.C. § 101 as directed to nonstatutory subject matter is made pursuant to

37 C.F.R. § 41.50(b).

- A new ground of rejection of claims 1-139 under 35 U.S.C. § 103(a) as obvious over McMenamin, Heath, APA, and Levitt is made pursuant to 37 C.F.R. § 41.50(b).

This decision contains new grounds of rejection pursuant to 37 C.F.R. § 41.50(b) (2007). 37 C.F.R. § 41.50(b) provides "[a] new ground of rejection pursuant to this paragraph shall not be considered final for judicial review."

37 C.F.R. § 41.50(b) also provides that Appellant, WITHIN TWO MONTHS FROM THE DATE OF THE DECISION, must exercise one of the following two options with respect to the new grounds of rejection to avoid termination of the appeal as to the rejected claims:

> (1) *Reopen prosecution.* Submit an appropriate amendment of the claims so rejected or new evidence relating to the claims so rejected, or both, and have the matter reconsidered by the Examiner, in which event the proceeding will be remanded to the Examiner. . . .
>
> (2) *Request rehearing.* Request that the proceeding be reheard under § 41.52 by the Board upon the same record. . . .

No time period for taking any subsequent action in connection with this appeal may be extended under 37 C.F.R. § 1.136(a). *See* 37 C.F.R. § 1.136(a)(1)(iv) (2007).

AFFIRMED IN PART
41.50(b)

jlb

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U.S. Securities and Exchange Commission

Speech by SEC Chairman: The Importance of Transparency In America's Debt Market

Remarks by

Chairman Arthur Levitt

U.S. Securities and Exchange Commission

At the Media Studies Center, New York, N.Y.

September 9, 1998

Thank you very much. Bob, thank-you for that generous introduction. I also want to thank the Freedom Forum and the staff of the Media Studies Center for all of their hard work in making this event possible.

As I walked in to the auditorium, I couldn't help but think back to my first job out of college as a young reporter for the *Berkshire Eagle* in Massachusetts. Although I spent most of my professional life on Wall Street, I never lost my interest in the media. After I left Wall Street, I found myself, once again, as a member of the press. But this time I wasn't a reporter. Nobody would hire me. Instead, I became the owner of *Roll Call* -- a newspaper which covers Congress.

Through those experiences, I observed first-hand the indispensable role the press plays in a democratic society. Now, as Chairman of the SEC, I see how quality financial news reporting brings emerging issues to our attention, augments our actions and arms investors with the knowledge to make informed decisions.

By reporting on issues ranging from price fixing in equities to microcap stock fraud to the disclosure of mutual fund fees, the press has made all of us more responsive -- and more accountable -- from the broker-dealer in New York to the fund manager in Boston to the government regulator in Washington.

The press and the SEC share a broad mission: to make available to the public vital, reliable and timely information to help ensure that officials and institutions -- public or private -- fulfill their fiduciary obligations and accept responsibility for their decisions and results. And so, I can think of no better place than the Media Studies Center to discuss the importance of transparency and disclosure -- particularly as it relates to America's long-term financial health.

First, I am concerned that certain mortgage-backed securities are being sold to individual investors without those investors fully understanding the risks involved. It's likely that many individual investors are not even aware of the variables that influence the return and duration of their investments.

I'm principally referring to the sale of collateralized mortgage obligations, or CMOs. Issued by either a federal agency or private corporation, a CMO is a bond backed by a large pool of home mortgages.

These are complex financial instruments. Even professionals require sophisticated analytical tools to evaluate them properly. I doubt that many individual investors realize exactly what they have purchased. I am also very troubled by reports that brokers may be marketing only the higher-risk classes – or tranches – to individual investors, while lower-risk classes are sold exclusively to institutions.

Second, we found anecdotal evidence of the possible misuse of inside information in the high-yield market. We were told that investment bankers and institutional investors who buy high-yield corporate bonds sometimes participate in syndicated loans for those same corporations issuing high-yield debt.

These participants in syndicated loans are entitled to send representatives to regular meetings with the borrower's management and bankers. Fine. But if confidential information from internal discussions in these meetings is being used or improperly leaked – affecting the prices of these companies' bonds – that would be unacceptable.

As I have said time and time before, insider trading – whatever its form – is plain and simply, wrong.

These matters are now under investigation and you can be sure that if we discover abuses, we will be quick to take action.

Conclusion

There is little doubt that the debt market is vital; that it has experienced strong growth; and, in many respects, is the backbone of corporate development in this country. But, these facts by no means guarantee its future prominence.

The imperatives of globalization and rapid advancements in technology have put a premium on information. Governments analyze and respond to it; the press reports and editorializes it; companies sell it; markets act on it; and investors rely on it.

Today, market information moves at the speed of light. The availability of accurate information to ensure the long-term stability of our markets has never been more important. The corporate debt market is not immune from these realities. And it would be folly to think otherwise.

I simply refuse to accept that this market cannot be as transparent as other markets. That logic runs counter to the values of trust, accountability, innovation and confidence that have been the hallmarks of America's

bicycles – or even telephones. Everything they need is at their fingertips.

Technology is revolutionizing how business is being conducted. But the corporate debt market remains one of the last major markets in the United States to not have some type of electronic price disclosure system. I think it is fair to say that the recent volatility in the markets underscores the need for greater price transparency in this market.

While everyone is familiar with the activity in the stock markets on August 31, most are probably unaware that there was virtually no buyer interest in the corporate bond market that same day. This lack of liquidity was readily apparent to the professional trader, but it was not known to the general public until reported by the press the following day.

What was not broadly reported – even after the facts – was the difficulty in the pricing of high-yield corporate securities. This, in turn, has a significant impact on a well-defined segment of mutual funds – those which heavily invest in the high-yield market.

Now, I am not suggesting that we transpose the national market system built for equities to the debt markets. For many reasons, that would not work. But it's time for this segment of the debt market to catch up with the times and the technology.

To address the lack of price transparency in the corporate debt market, I have called on the National Association of Securities Dealers to do three things:

First, adopt rules requiring dealers to report all transactions in U.S. corporate bonds and preferred stocks to the NASD and to develop systems to receive and redistribute transaction prices on an immediate basis;

Second, create a database of transactions in corporate bonds and preferred stocks. This will enable regulators to take a proactive role in supervising the corporate debt market, rather than only reacting to complaints brought by investors; and

Third, in conjunction with the development of a database, create a surveillance program to better detect fraud in order to foster investor confidence in the fairness of these markets.

I am pleased to report to you that the NASD is moving forward on all of these recommendations. This is an important step. These actions will likely result in a higher level of price transparency for the corporate debt market than what currently exists in municipal securities. And, with the strong improvements the municipal markets have undertaken recently, this is no small accomplishment. I hope that, in the near future, corporate securities will no longer be lagging, but rather leading in the pursuit of greater price disclosure.

Additional Findings

As I stated at the outset, we believe that, overall, the bond market is functioning effectively. We did, however, find certain sales practices which I find troubling.

The bond market touches all aspects of our lives – from the cost of building schools and hospitals to corporate investment in areas such as plants and equipment. It impacts the assets of public and private pension funds. It channels capital to mortgage and car loans. It even influences revolving credit.

This market also affects the prices in the equity market that everyone follows so closely. If you cannot value a company's debt accurately, it is difficult to determine the baseline value of its equity.

The bond market's economic significance is matched only by its sheer size. While New York Stock Exchange equity trading amounts to $28 billion per day, trading volume in all bond markets totals roughly $350 billion per day. U.S. corporate bonds outstanding have more than quadrupled since 1980. Municipal bonds have experienced similar growth. The total value of the bond market today is over $10 trillion – up approximately 400 percent since 1980. Some tend to think of the financial market solely as an equity market. These numbers should correct that impression.

Review of the Bond Market

Our initial review of debt securities found that, as a whole, the market for government securities is characterized by high-quality pricing information for investors. We are also confident that, because of steps taken over the last few years, transparency is much greater in the municipal securities market. But, we believe that in the area of corporate bonds, price transparency is simply not up to par.

Historically, the debt markets have lagged well behind the equity markets in making price information available to investors and the public. There are good reasons for this: the debt market covers a much wider variety of instruments and is largely institutional. Nonetheless, the Commission, on several occasions, has acted to encourage debt market transparency.

In 1991 – with encouragement from the Commission and Congress, GovPX – a 24-hour, world-wide electronic reporting system – was formed to distribute real time quotes and transaction prices for U.S. Treasury and other government securities. As a result, these markets now enjoy a higher level of quality price information.

In 1995, again with the SEC's active encouragement, the Municipal Securities Rulemaking Board began collecting the details of dealer-to-dealer transactions in the municipal bond market and distributing daily summary reports. And, just last month, with SEC approval, the MSRB expanded its daily reporting to include customer trades as well as inter-dealer trades.

Now, for the first time, investors, particularly smaller investors, have access to the prices and volume data of municipal bond trading between dealers and their customers. And, our effort is not stopping there. I expect that these actions will culminate in immediate transaction price reporting – making the municipal bond market as transparent as it can possibly be.

It's now time for the corporate bond market to step up to the plate. The need has never been more evident. These days, bond dealers do not need

History of U.S. Bond Market

There seems to be a common misconception that the bond market is somehow less important than the equity market. But history shows, if anything, that the opposite may be true. The bond market has played an important role in this country's development from the very first days of the republic. The New York Stock Exchange, in fact, originated in 1792 as a bond exchange. For the first time, securities issued by the new United States government could be readily bought and sold. Those first government bonds funded the debt of the American Revolution. Treasury Secretary Alexander Hamilton not only helped create a new money supply, but he also linked the interests of wealthy bondholders to the fate of the new country.

As American corporations formed and evolved, a market for the issuance of corporate bonds followed suit. Between 1850 and the early 1900's, railroad company bonds dominated the corporate debt market. Those bonds fostered the growth of more railroad companies than there are Starbucks in Manhattan. At the same time, an expanding number of public utilities and industrial corporations were also issuing bonds. Between 1900 and our entry into World War I, corporate debt tripled from $6 billion to over $19 billion – exceeding the federal debt.

Bonds in those days were sold to a great extent door-to-door – literally. It was not unusual for Wall Street bond firms to hire a salesman and send him out with a bicycle, a designated territory and a list of bonds to sell. The salesman would cycle to storekeepers, farmers and country banks in the hopes of selling at least one bond a week.

As equities came to dominate the New York Stock Exchange, the vast majority of bond issues – whether Treasury bonds or corporate bonds – moved to trading on the over-the-counter market. For most of the 20th century, bonds were considered, in the words of one writer, "the staid province of high-quality borrowers...and highly conservative investors and creditors."

And, as recently as the early 1970's, most bond holders were still clipping interest coupons – mailing them in to be redeemed. Simply put, bonds were bought and held. This, in part, reflected the slow movement of long-term interest rates. "Debt money," as Edmund Burke summarized in the 18th century, "is static." For a good part of this century in this country, Burke's statement rang true.

Recent Characteristics of the Bond Market

However, with the onset of inflation in the mid-1970's, deficit spending in the 1980's and the proliferation of technology in the 1990's, the debt market fundamentally changed in practice and in scope.

Long gone are the days of bond sellers on bicycles. Global electronic markets, computer-based analytical services and rapid fluctuations in bond prices are the order of the day. It's now a fast-moving medium that plays a major role in America's economy.

In recent weeks, that has come into question. We've watched in awe as the perennial see-saw between bulls and bears has fallen and risen dramatically. And yet, despite the uncertainty we've witnessed, confidence remains strong.

Confidence doesn't make markets rise and it doesn't make markets fall. It makes markets possible. Without it, there would be neither buying nor selling. There would be silence.

Someone once noted that "Confidence awakens confidence." It is the underlying reason why America's capital markets are as strong as they are today. Transparency, disclosure and accountability aren't just catchwords. They are the essential ingredients to confidence. And without it, markets can neither sustain long-term growth nor adapt to a rapidly changing environment.

In the current financial situations in Asia and Russia, the word transparency has been employed rather frequently. Transparency is critically important in a number of ways. For instance, it's an issue in how publicly a government considers policies, or how a company's revenue is derived and what its true expenditures are, or how a bank's loan portfolio is constituted.

For securities markets, transparency is the extent to which timely data on prices are visible and understandable to all participants. At various times, some market participants have resisted efforts to increase the availability of information to investors. But experience has proven, again and again, that transparency -- to borrow from President Kennedy -- is a tide that lifts all boats.

Earlier this year, the SEC began reviewing the market for debt securities in the United States -- with a particular emphasis on the state of price transparency. This morning, I want to report to you the staff's preliminary findings. I also want to discuss what steps I believe should be taken to help ensure that all sectors of the bond market are functioning as fairly and efficiently as possible.

Today, anyone who buys a car, or a house, or even a piece of fruit can obtain prices on identical or comparable items to guide their decision. But in certain parts of the bond market you need a research department and a trading department to discover such information. How many individual investors do you know who can afford those resources?

The sad truth is that investors in the corporate bond market do not enjoy the same access to information as a car buyer or a homebuyer or, dare I say, a fruit buyer. And that's unacceptable. Guesswork can never be a substitute for readily available price data.

So today, I am calling for increased price transparency in the corporate debt market. We are doing so for one simple reason: investors have a right to know the prices at which bonds are being bought and sold. Transparency will help investors make better decisions, and it will increase confidence in the fairness of the markets. Simply put, it's in everybody's interests.

capital markets.

Cicero once wrote that "Nothing so cements and holds together all the parts of a society as faith or credit." But faith and credit are not just simply arrived at through terms on a piece of paper. They are painstakingly forged over years in the day in and day out practices of a society.

The American experience proves that public disclosure is not a theoretical concept but a living principle. Everyday practices – whether in government, the media, academia or finance – when examined through the public lens, attain a measure of veracity and probity that would not exist if consummated under the veil of darkness.

Transparency is both a means and an end. It plays a fundamental role in making our capital markets the most efficient, liquid and resilient in the world. And, at the same time, transparency is a goal. We know from our own past experience and from the current situation in Asia and Russia that there is a direct relationship between information and investor confidence: Increase one and you increase the other; decrease one and you decrease the other. This is not rocket science. The choice is clear.

If we continue to be vigilant in the dissemination of market information to all investors, our nation's markets will remain the envy of the world. You can be sure the SEC will do its part. I expect *all* our markets to do theirs.

Thank you.

http://www.sec.gov/news/speech/speecharchive/1998/spch218.htm

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